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**PROGRAM FOR DEVELOPMENT OF PRODUCTION CHAINS TO
PROMOTE EXPORT-ORIENTED MICROENTERPRISES AND SMALL
AND MEDIUM-SIZED BUSINESSES IN GUANAJUATO**

(TC-03-02-01-3-ME)

DONORS MEMORANDUM

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CONTENTS

EXECUTIVE SUMMARY

I.	COUNTRY AND PROGRAM ELIGIBILITY	1
II.	BACKGROUND FACTS	1
	A. Production in Guanajuato and the economic environment	1
	B. Guanajuato production cluster profiles	2
	C. MIF and Bank strategy	3
III.	PROGRAM OBJECTIVES AND DESCRIPTION	4
	A. Program objectives.....	4
	B. Components and activities.....	4
	1. Component 1: Coordination with enterprises and production chain formation	5
	2. Component 2: Implementation of the sector integration plan.....	5
	3. Component 3: Modernization of COFOCE company assistance services..	6
	4. Component 4: Dissemination of the model and outcomes	7
IV.	PROGRAM COSTS AND FINANCING.....	7
	A. Cost and financing	7
	B. Program sustainability	8
	C. Readiness	8
V.	PROGRAM EXECUTION	9
	A. Executing agency	9
	B. Executing mechanism	9
	C. Execution and disbursement periods.....	11
	D. Accounting and audits	11
VI.	MONITORING AND EVALUATION.....	11
VII.	RATIONALE AND RISKS	13
	A. Rationale.....	13
	B. Program beneficiaries	13
	C. Risks	14

VIII. SOCIAL AND ENVIRONMENTAL ASPECTS.....	14
IX. SPECIAL CONTRACTUAL CONDITIONS	15

ANNEXES

Annex I	Logical framework summary
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ABBREVIATIONS

ANPIC	Asociación Nacional de Proveedores de la Industria del Calzado (National Association of Footwear Industry Suppliers)
CEVEM	Centro de Vinculación Empresarial de Guanajuato para el Sector de Cuero y Calzado (Center for Entrepreneurial Cooperation for the Leather and Footwear Sector of Guanajuato)
CIATEC	Centro de Investigación y Asesoría Tecnológica en Cuero y Calzado de Guanajuato (Center for Technological Research and Consultation on Leather and Footwear of Guanajuato)
CICEG	Cámara de la Industria del Calzado de Guanajuato (Chamber of the Footwear Industry of Guanajuato)
CICUR	Cámara de la Industria de Curtiduría (Chamber of the Leather Tanning Industry)
CIEX	Centro de Innovación para la Exportación de COFOCE (COFOCE Center for Export Innovation)
COF/CME	Bank's Country Office in Mexico
COFOCE	Coordinadora de Fomento al Comercio Exterior de Guanajuato (Foreign Trade Promotion Coordinator of Guanajuato)
CONCAMIN	Confederación de Cámaras de Industria de México (Confederation of Chambers of Industry of Mexico)
DACE	Dirección Adjunta al Comercio Exterior del COFOCE (COFOCE Deputy Directorate of Foreign Trade)
DAPE	Dirección Adjunta de Promoción de Exportaciones del COFOCE (COFOCE Deputy Directorate of Export Promotion)
FIDECAP	Fondo de Desarrollo de Encadenamientos Productivos (Fund for Productive Chain Development)
FUNTEC	Fundación Mexicana para Innovación y Transferencia Tecnología (Foundation for Technological Innovation and Transfer)
GDP	Gross Domestic Product
ME	Ministry of the Economy
MSMEs	Micro, Small and Medium Enterprises
PCU	Program Coordination Unit
PD	Program Executive Director
PROCIC	Program for Footwear Industry Competitiveness
SC	Project Steering Committee
STC	Comité Técnico Sectorial del Calzado o de Cerámica Decorativa (Sector Technical Committee on Footwear and Decorative Ceramics)
UNDP	United Nations Development Programme

**PROGRAM FOR DEVELOPMENT OF PRODUCTION CHAINS TO PROMOTE
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(TC-03-02-01-3-ME)

EXECUTIVE SUMMARY

Requester and executing agency:	Coordinadora de Fomento al Comercio Exterior [Foreign Trade Promotion Coordinator] (COFOCE) for the State of Guanajuato, Mexico.	
Beneficiaries:	The direct beneficiaries of the program are 200 micro-, small, and medium-sized enterprises (MSMEs) of goods and services in selected productive sectors (leather-footwear, decorative ceramics and garment making), and local public and private research institutions and centers, universities and service providers. Some 300 other MSMEs will benefit indirectly.	
Financing:	MIF (Facility III-A):	US\$1 million
	Local counterpart:	<u>US\$1 million</u>
	Total:	US\$2 million
Terms:	Execution period:	36 months
	Disbursement period:	42 months
Objectives:	The program's general objective is to increase the competitiveness of microenterprises as well as small and medium-sized enterprises (MSMEs) in selected sectors of Guanajuato, by strengthening business cooperation and integration methods. The specific objective is to integrate the MSMEs of Guanajuato into the export process directly or indirectly through the development and strengthening of production integration in the selected sectors.	
Description:	The program comprises four components aimed at the formation of sustainable production chains in two key sectors of the Guanajuato economy, consisting primarily of export-oriented SMEs in the areas of leather-footwear and ceramics. These components are: 1. coordination among enterprises and production chain formation; 2. implementation of sector integration plans; 3. modernization of COFOCE enterprise services and formation of the executing unit; and 4. evaluation and dissemination of the model and outcomes. The component 2 activities are a consequence of the component 1 activities.	

The garment making sector will receive support only under component 1, since available funds exist through the Fund for Production Chain Development (FIDECAP) of the Federal Ministry of the Economy, which may be used to implement the integration plan for that sector.

The outcome of the first component, consisting basically of strengthening the ties of cooperation between the enterprises and institutions in each cluster and planning common objectives and activities, will constitute the basis for the rest of the actions contemplated in the program.

**Environmental
and social
review:**

The Committee on Environment and Social Impact (CESI) considered this operation on 20 March 2003, and its recommendations were included in paragraphs 3.5, 3.7, 6.4, 6.5, 7.4, 8.1, and 8.2. Four measures in particular will be taken to mitigate any possible environmental risks from the program: (i) making existing risk-mitigating instruments available, through existing environmental facilities and state institutions; (ii) coordinating the MIF Project with promoting cleaner production opportunities in the Bajío region; (iii) providing training and advisory assistance for practitioners in occupational health and safety issues.

**Special
contractual
clauses:**

Conditions precedent to the first disbursement will be the submission, to the Bank's satisfaction, of the following: (i) working plan for year one of the project; (ii) evidence that the Program Coordination Unit has been formed and that the Project Executive Director and assistant have been hired; and (iii) evidence that the Steering Committee has been formed.

For purposes of component 2, disbursements be flexible enough to permit each sector to be carried out separately, once each integration plan under component 1 is ready.

For disbursements under subcomponents 2.1 and 2.2, COFOCE must submit, to the Bank's satisfaction: (i) integration plans for the leather-footwear and decorative ceramics sectors; and (ii) the Sector Technical Committees operating in each sector with their respective sector coordinators.

**Exceptions to
Bank policy:**

None.

I. COUNTRY AND PROGRAM ELIGIBILITY

- 1.1 The Donors Committee declared Mexico eligible for all types of financing from the Multilateral Investment Fund (MIF) on 21 January 1994. The program is consistent with the MIF eligibility criteria under Window III-A, particularly the Production Chains and Network Development cluster, insofar as (i) the executing agency has had experience working with SMEs; (ii) there has been cooperation in the past between businesses in Guanajuato although such experiences either have not been consolidated or are still in their early stages, bringing together just a few businesses; and (iii) COFOCE has expectations of specific markets that are prepared to buy products from Guanajuato for the sectors identified.
- 1.2 This is the fifth program in the MIF cluster mentioned earlier. The lessons learned and best practices identified in a specialized consultancy that developed a specific evaluation methodology for these projects were taken into account in preparing the program.

II. BACKGROUND FACTS

A. Production in Guanajuato and the economic environment

- 2.1 The population of the state of Guanajuato is estimated at 4.6 million inhabitants. With annual per capita GDP of US\$4,100, Guanajuato ranks seventh among Mexico's states in economic importance. The major sectors are the automotive industry, textiles and apparel, leather and footwear, commerce, construction, tourism, agriculture, ceramics, and chemicals. State exports grew between 1995 and 1999 from US\$1.5 billion to US\$4.6 billion, accounting for 35% of Guanajuato's economy, of which 67% centers on the General Motors plant in Silao. Manufacturing represents 57% of the State's economic production and 95% of manufacturing companies are microenterprises and small businesses.
- 2.2 The state of Guanajuato has the necessary strengths for adopting a successful production integration model for micro-, small, and medium-sized enterprises (MSMEs), since it has: (i) a strong manufacturing tradition; (ii) a large supply of experienced, skilled labor; (iii) universities and technical institutes; and (iv) public and private technical and financial service providers. Notwithstanding the state's productive potential, the major manufacturing sectors (i.e. leather-working and shoes, garment making, and ceramics) in which companies are predominantly MSMEs, face the challenge of enhancing their competitiveness in a shrinking domestic market characterized by aggressive pricing. MSMEs provide a viable alternative for penetrating world markets, which means they must adopt improvements in technology and production, and enter into other forms of cooperative arrangements to meet the demands for higher quality, volume and added-value. (Table No. 1 below shows the specific sector trends).

B. Guanajuato production cluster profiles

- 2.3 A study financed by the MIF's Italian Trust Fund, in response to a request from entrepreneurs, was completed in February 2003 by the Guanajuato Foreign Trade Promotion Coordinator (COFOCE). The study confirms the potential of supporting production integration initiatives in Guanajuato to integrate the MSMEs into global markets. In this study, three sectors were selected: leather-making and footwear, garment making and decorative ceramics, consisting primarily of MSMEs and support institutions.
- 2.4 These three sectors were also selected on the basis of: the impact of these industries on the state economy, where almost 9,000 enterprises employ about 120,000 workers in these three sectors alone; geographic location and concentration; target markets; presence and linkages with local institutions; interest of companies and potential for cluster development; prospects for growth and the impact on the local economy.

Table 1
Key features, challenges and common objectives by cluster

Sector	Cluster features	Challenges	Common working areas
Footwear, leather-making, suppliers	<p>Footwear: 3,500 MSMEs generating 67,000 direct jobs. In 2002, exports of US\$152 million (1.7% of the State total).</p> <p>Leather and suppliers: 1,245 MSMEs generating 12,000 jobs. In 2002, exports of US\$143 million (1.5% of the State total).</p> <p>There are "pace-setting" large and medium-sized enterprises with access to world markets</p> <p>They are organized into trade unions¹</p>	<ul style="list-style-type: none"> • Fewer exports due to international competition, contraband and peso appreciation: In 2001 and 2002, exports fell from 16 to 6 million pairs annually. • Competitive delays due to production costs, failure to adapt product design and quality. • Low individual production, sales volume and inadequate export logistics. • Few enterprises have access to the external market. 	<ul style="list-style-type: none"> • Access to world markets, to introduce process and product innovation and designs. • Strengthen chain specialization (niches) and sector cooperation (for example, joint brand) • Linkage with local specialized centers in the sector to improve quality and design, etc.

¹ National Association of Leather Industry Suppliers (ANPIC); Guanajuato Chamber of the Footwear Industry (CICEG); Chamber of the Leather Tanning Industry (CICUR).

Table 1
Key features, challenges and common objectives by cluster

Sector	Cluster features	Challenges	Common working areas
Decorative ceramics	2,000 small craft workers, manufacturers, and suppliers employ between 15,000 and 20,000 persons. There are pace-setting medium-sized companies with access to external markets. The enterprises also have trade union support, and are located in the Dolores de Hidalgo area. For 2002, sector exports totaled US\$55 million.	<ul style="list-style-type: none"> • Inefficient production and strong competition among workshops with little production specialization • No appropriate distribution channels. • Designs and quality are not market-adapted. • Lack of product or process innovation. • Few enterprises have access to the external market. 	<ul style="list-style-type: none"> • Strengthen sales channels and build linkages with export firms, • Promote joint design, • Establish an assignation of origin. • Create mechanisms for cooperation on greater production volumes
Manufacturing	Close to 2,600 established enterprises with 31,000 employees, including suppliers. It represents 3.9% of the State GDP. Between 2000 and 2001, the textile and manufacturing sector GDP fell by about 9%. Sector exports in 2002 totaled US\$347 million (3.94% ² of State exports).	<ul style="list-style-type: none"> • Low integration and trade unionization levels that make it difficult to market large international orders • Fierce competition from Asian producers that have adopted the “full package” model.³ 	<ul style="list-style-type: none"> • Promote the benefits of establishing MSME clusters • Create a center for joint design and sponsorship. • Set up a common distributor.

2.5 This program works on the factors that hinder such integration, chiefly, low production specialization in each company, lack of experience in business cooperation, and little development of shared-use entrepreneurial support services. Moreover, the linkage depends on support from the technological institutes and the existing service providers in Guanajuato through methodologies for working with MSME clusters.

C. MIF and Bank strategy

2.6 This program complements three other projects supported by the MIF in the State of Guanajuato: (i) **production integration project** (ATN/MT-7139-ME), executed by CONCAMIN/FUNTEC (Confederation of Mexican Chambers of Industry/Fund for Technological Innovation and Transfer) in Mexico City, which supports the footwear industry in the state of Guanajuato. Independent consultations, as well as

² If automotive sector exports are excluded, manufacturing represents approximately 22% of the State’s remaining exports.

³ The distinctive factor that makes Asian exports more competitive is not based on price, but rather the full package, meaning that the enterprise is able to manage the productive process where the customer wants it, guaranteeing total flexibility and the ability to handle the process at any point.

the mid-term evaluation, indicate that this project lacks the scope to become a methodological model for COFOCE, since it focuses on basic technical assistance and skills training for individual microproducers of footwear through CEVEM (Center for Entrepreneurial Cooperation for the Leather-Footwear Industry of Guanajuato); (ii) **promotion of cleaner production opportunities in the Bajío region** (TC-02-02-01-2-ME), which will facilitate the use and implementation by MSMEs of cleaner production systems to improve the efficiency and productivity of SMEs in the Guanajuato region, making available up to US\$4,000 to each enterprise, under a matching grant; and (iii) the **Guanajuato Capital Development Fund** (EQU/MS-6463-ME) to facilitate small enterprise development, combining development goals and venture capital discipline, with tangible results for the local economy.

- 2.7 It is also complemented by a training program for consultants and facilitators of production integration programs initiated by the United Nations Development Programme (UNDP) in Mexico.

III. PROGRAM OBJECTIVES AND DESCRIPTION

A. Program objectives

- 3.1 The program's general objective is to increase the competitiveness of micro- small, and medium-sized enterprises (MSMEs) in Guanajuato, in the leather and footwear, ceramics and garment-making industries, through closer cooperation and business integration industries.
- 3.2 The specific objective is to integrate the MSMEs of Guanajuato into the export process directly or indirectly through production integration development and strengthening in the selected sectors.

B. Components and activities

- 3.3 The program contains four components aimed at forming sustainable production chains for export-oriented SMEs: 1. coordination among enterprises and production chain formation; 2. implementation of sector integration plans; 3. modernization of COFOCE enterprise services; and 4. evaluation and dissemination of the model and outcomes. The Component 2 activities develop further the activities of Component 1. The garment-making industry will receive support only under Component 1, since available funds exist through the Fund for Productive Chain Development (FIDECAP) of the Federal Ministry of the Economy, which may be used to implement the integration plan.

1. Component 1: Coordination with enterprises and production chain formation (MIF: US\$111,600 and counterpart: US\$34,600)

- 3.4 This component seeks to help businesses learn how to cooperate with local competitors, suppliers and sector-supporting institutions, in order to develop collective plans that improve production, marketing and management, through awareness-raising activities for enterprise clusters in the leather and shoemaking, decorative ceramics and garment making industries.
- 3.5 It includes training and technical assistance: (i) to conduct group workshops to identify competitiveness problems that may be resolved by production integration and draw up solution strategies with the cluster in each sector initially interested in participating in the project; (ii) to assess a sample of enterprises to determine the competitiveness factors of value chains and areas of collaborative work opportunities, including environmental management and industrial safety. For the leather-footwear sector, the CEVEM analysis and the PROCIC (Program for Competitiveness in the Footwear Industry) study will be used; (iii) to prepare the integration plan⁴ for the leather-footwear, ceramics and garment-making industries, with the corresponding logical framework, budgets and baseline for evaluation; and (iv) to train the responsible sector coordinators to facilitate integration in each sector.
- 3.6 As a result of this component, the enterprise clusters in each sector will be identified and supported, defining three-year sector integration plans as an vehicle for coordinating efforts. These plans will include the baseline for the project impact evaluation, to be performed with a more precise assessment. There will also be staff training in business integration.

2. Component 2: Implementation of the sector integration plan (MIF: US\$799,400 and counterpart: US\$684,200)

- 3.7 This component will help enterprise clusters in the leather-footwear and ceramics industries tailor their products to external demand, which involves adjusting their production and management processes for more integrated operation. Sector Technical Committees will be organized for both industries and, although the activities depend on the integration plans to be finalized in Component 1, the actions initially identified by COFOCE and the enterprises are as follows:
- a. **Subcomponent 2.1. Leather and footwear:** will support clusters with technical assistance and training activities: (i) to develop entrepreneurial collaboration with foreign technical assistance and internships in counterpart clusters,

⁴ The Integration Plan will reflect the agreement reached by the enterprise clusters on activities to which they are committed for the formation of the cluster or integration project. This Plan must include goals, objectives and instruments, and define the obligations of the various participants.

including support for the creation of export company-based consortiums; (ii) to improve the operational effectiveness of chains with the support of the Center for Technological Research and Consultation on Leather and Footwear in Guanajuato (CIATEC), including suppliers and producers (individually complementing the CEVEM activities); (iii) to develop products with advisory assistance from external designers according to the demands of enterprise clusters; (iv) to promote joint production marketing through the identified export markets, training in export techniques and international advertising campaigns; and (v) to disseminate know-how and best practices to the enterprises and workers on environmental issues and on health and safety in the workplace, supplementing the concrete activities of other projects in the country and the MIF cleaner production project in the Bajío region mentioned in paragraph 2.9.

- b. **Subcomponent 2.2. Ceramics:** Support for this sector consists of technical assistance and training (i) to bring craftworkers into the marketing chain and define other collaborative efforts; (ii) to advise and train enterprise clusters on management practices and joint production organization, including the shared use of equipment and the use of acceptable materials under Mexican environmental and occupational safety standards; (iii) to develop suppliers, using larger exporters as “pace-setters”; (iv) to obtain “assignment of origin” for leather products from Guanajuato; (v) to disseminate know-how and best practices to the enterprises and workers on the environment and on health and safety in the workplace, in partnership with other ongoing programs in the country and the MIF cleaner production project in the Bajío region; and (vi) from a market integration viewpoint, to develop elements of packaging, logistics, product design and promotion.

3.8 Foreign trade promotion activities for both components, including trade mission participation (two annually for each sector), market information, and export processing assistance, will be supported and financed by COFOCE, this being its normal field of work. When appropriate, national and international assistance will culminate with training events, to maximize the support provided by the project consultants.

3.9 As a result of this component, the enterprises will be expected to have implemented joint programs for improving production and management, assisted by the Program Coordination Unit and the sector coordinators, and the enterprises as a whole will have increased their sales through linkages with the export chain.

3. Component 3: Modernization of COFOCE company assistance services (MIF: US\$0 and counterpart: US\$275,200)

3.10 Although the executing agency, COFOCE, works primarily in export promotion, increased competitiveness is a necessary condition for integrating the MSMEs into export processes. The challenge lies in how COFOCE can spur more integrative

processes that reach beyond its functions, effectively coordinating with existing public and private institutions and, in turn, developing enterprise expertise. This involves formulating a working methodology geared to COFOCE's foreign trade-oriented culture.

- 3.11 Among the key activities are: (i) designing and implementing an Annual Survey to monitor the evolution of MSME behavior in the export process; (ii) developing and strengthening cooperation mechanisms between the MSMEs, technical assistance providers and institutions for sharing technical assistance (including environmental aspects), identifying sources of financing; (iii) setting up a technical information databank on suppliers and sector-relevant information in the area of technical assistance, to enable COFOCE to monitor the services provided to the enterprises; and (iv) establishing a policy on national and international partnerships to support programs of this kind; and (v) establishing an information system for the program.
- 3.12 Accordingly, this component will complement COFOCE's enterprise-relevant tasks, as the proponent of a sustainable production integration model with pertinent intervention methodologies to facilitate MSME inclusion in the export process.

4. Component 4: Dissemination of the model and outcomes (MIF: US\$41,000 and counterpart US\$6,000)

- 3.13 This component will set in motion an information system for ongoing management, follow-up and evaluation of the program, and will disseminate the business development model applied and outcomes to other institutions in Mexico and other countries. It includes: (i) documenting efforts carried out through the sector integration plans; (ii) systematizing lessons learned, with an emphasis on case studies and best practices and development of materials for dissemination; (iii) establishing effective methods of reaching out to interested potential clusters. Also included are expenses for monitoring that would be administered by the MIF for follow up on the project under the Production Chains cluster.

IV. PROGRAM COSTS AND FINANCING

A. Cost and financing

- 4.1 The cost of the program has been estimated at the equivalent of US\$2 million, of which US\$1 million will be contributed by the MIF and US\$1 million will come from the local counterpart, mainly in cash, except for administrative expenses, as shown below (the itemized budget is presented in Annex II):

Table 2
General Budget

	MIF	Counterpart	Total	%
I. Component 1. Coordination between enterprises and production chain formation	111,600	34,600	146,200	7.6
II. Component 2. Implementation of integration plans	799,400	684,200	1,483,600	74.0
III. Component 3. Modernization of COFOCE enterprise services	0	275,200	275,200	14.0
IV. Component 4. Dissemination of the model and MIF cluster	41,000	6,000	47,000	2.0
<i>C. Evaluation and audits</i>	28,000	0	28,000	1.4
<i>D. Contingencies</i>	20,000	0	20,000	1.0
Total	1,000,000	1,000,000	2,000,000	100.0

4.2 The MIF funds will be used primarily to cover specialized consulting costs in Components 1 and 2 and program dissemination activities. The counterpart contributions will be used to pay the program director's fees, foreign trade support costs and infrastructure expenses (leases, services, transportation, etc).

4.3 The program will finance, on average, 50% of the training and technical assistance services for the enterprises in each of the selected clusters, to a maximum of US\$7,500 for each enterprise. At the outset of the program, 70% will be financed, then this percentage will be reduced, so that, by the end of the third year, 30% will be financed.

B. Program sustainability

4.4 The program's sustainability is based on the following factors: (i) COFOCE's institutional learning curve, which will strengthen its capacity to implement programs aimed at bringing the MSMEs into the export process; (ii) capacity to coordinate with state and federal support mechanisms that can be used in this kind of program and on which both the COFOCE staff and the cluster coordinators will have to be trained; and (iii) development of a non-financial services market for enterprises, which will put a value on support services, increase the demand for such services and the willingness to pay for them.

C. Readiness

4.5 The program is at an advanced state of readiness, since (i) it has previous analyses and, in the specific case of the leather and footwear industry, the PROCIC study; (ii) the general program activities, approved by COFOCE and the entrepreneurs,

have been carried out with sufficient detail; and (iii) there is a decent level of coordination between COFOCE and the institutions supporting the MSMEs.

V. PROGRAM EXECUTION

A. Executing agency

- 5.1 The program will be implemented by COFOCE, which was created in 1992 as a decentralized agency of the government of the state of Guanajuato. COFOCE is the product of the state's experience with public and private management in the last decade. Its programs, through three Divisions (Export Promotion (DAPE), Center for Export Innovation (CIEX) and Foreign Trade (DACE), prepare companies for export activity, assisting them in that regard with innovative product development and promoting them in the external markets. COFOCE, with 104 employees, has a network of export offices abroad (Dallas, Los Angeles, Santa Ana, Hong Kong, Costa Rica, Spain, and Japan) and in Guanajuato in the cities of León, Moroleón, Uriangato, Irapuato, Rincón, Celaya, and San Miguel de Allende.
- 5.2 COFOCE has the institutional capacity to implement this project, to manage its resources effectively and transparently, and to plan its outcomes after the project ends. Its management bodies include public sector representatives and educational and research institutions, as well as the most representative chambers of industry in the private sector.⁵ The institution has ISO 9002 certification.
- 5.3 The COFOCE has an annual budget (sourced largely by public funds),⁶ of approximately US\$25 million, and its Board of Directors has notified the Bank that it will commit US\$1 million to this program for a three-year period. Although COFOCE has no prior experience working with multilateral institutions, it has entered into agreements in the last few years with approximately 12 national and international institutions, basically in the academic and technological development fields, enabling it to coordinate technical assistance, training, and innovative know-how for businesses.

B. Executing mechanism

- 5.4 Three administrative levels will be set up: (i) a **Steering Committee** to be created at the start of the program, as the project's highest decision-making body; (ii) a **Program Coordination Unit (PCU)**, with its respective executive director under the CIEX; and (iii) two **Technical Sector Committees**, which will operate locally,

⁵ The Chairman of the Board is an entrepreneur, employed full-time without compensation, whose appointment by the enterprise export community is ratified by the Governor of the state.

⁶ It has recently included the sale of enterprise services, generating budget revenue.

with their respective coordinators and work team, one for the leather-footwear sector and the other for ceramics. The duties and responsibilities of the various agencies and individuals are described in the Operating Regulations.

- 5.5 The Steering Committee will consist of the President and Managing Director of COFOCE, three Deputy Directors of the CIEX, DAPE and DACE, and two private sector representatives. Among its responsibilities are: (i) to approve the project strategy, targets, and general budget; (ii) to analyze and approve the annual work plan; (iii) to approve the three sector integration plans; (iv) to approve the hiring of the respective sector coordinators and the appointment of members to the Sector Technical Committees; (v) to oversee and analyze the program's progress and budget execution on the basis of the PCU reports; (vi) to propose improvements in project design and implementation for purposes of ensuring its outcome and impact; and (vii) to approve the reports to be submitted periodically to the IDB/MIF.
- 5.6 The PCU, consisting of an **Executive Director** and a full-time administrative assistant, will be responsible for, among other things: (i) preparing and executing the Annual Work Plans (AWP); (ii) coordinating project activities; (iii) procuring and monitoring goods and services, (iv) processing disbursement requests to the Bank; (v) submitting project statements of account and management reports to the Steering Committee for submission to the Bank; and (vi) monitoring the performance indicators established in the logical framework. The PCU representative will be the Program Executive Director, a CIEX official engaged full-time on the program and appointed pursuant to Bank procedures, whose specific duties are described in the Operating Regulations (the terms of reference are attached).
- 5.7 In Component 2, to implement the integration plans for the leather-footwear and decorative ceramics sectors, two **Sector Technical Committees** will be set up, under the responsibility of two **sector coordinators**. On the Committees will be: (i) sector representatives; (ii) the respective local COFOCE representative; and (iii) a representative from the academic sector or related service centers, and any other representatives which the Sector Technical Committee (STC) or Steering Committee may suggest. These STCs must be set up in month three of the project and be operating by month four. They will be in charge of managing and monitoring the proper implementation of the integration plans for the leather-footwear and ceramic sectors. For the committees to function smoothly, it is recommended that there not be more than five members.
- 5.8 The sector coordinators will report to the Executive Director and the Technical Committee, and their principal duties include: (i) to describe in detail sector enterprise activities in the respective integration plan; (ii) to assist in the formation of the working group for each cluster; (iii) to prepare action plans for each enterprise cluster with the help of consultants; (iv) to assist in the contracting of

technical assistance and training services; (v) to facilitate institutional cooperation; and (vi) to administer all joint activities carried out by each cluster within the program framework, including the attainment of cost recovery targets.

C. Execution and disbursement periods

- 5.9 The program will have a 36-month execution period, with financing disbursed over 42 months. A revolving fund in an amount of up to the equivalent of 10% of the MIF contribution will be established and administered in a separate account.

D. Accounting and audits

- 5.10 COFOCE will be responsible for the following: (a) establishing and maintaining an adequate internal financial-accounting control system, structured to provide the documentation necessary to verify transactions and facilitate timely preparation of program financial statements and reports. The program records must be kept such that: (i) they permit identification of the amounts received from the various sources; (ii) they show, according to the Bank-approved chart of accounts, the allocation of funds contributed to program expenses, as well as other funds that must be contributed to fully execute the program; (iii) they include the sufficient detail to identify the goods procured and services contracted, as well as the use of such goods and services; and (iv) they evidence the cost of the activities in each component; (b) the opening of separate bank accounts for administration of the MIF contribution and the local counterpart funds; (c) processing of disbursement orders and the respective justification of expenses, in accordance with the Bank's standard procedures; and (d) the preparation and submission to the Bank of the program annual financial statements, audited by an independent auditing firm or consultant acceptable to the Bank, in accordance with the terms of reference previously approved by the Bank. The cost of the final program audit will be financed out of the MIF funding. The Controller's Office of COFOCE will provide oversight to ensure that the funds are employed properly.

VI. MONITORING AND EVALUATION

- 6.1 **Progress reports.** The PCU will prepare and submit progress reports to the Bank's Country Office in Mexico (COF/CME) within 30 days following each six-month period, and a final report 30 days after the final disbursement. For the first annual progress report, the PCU will also prepare the work plan for the second year. These reports will follow a format previously agreed with the COF/CME, and will cover the activities, financial performance and outcomes. The COF/CME will use these reports to monitor project progress and prepare a final report within three months after the last disbursement.

- 6.2 **Management reports.** The PCU, jointly with the sector coordinators, will prepare quarterly management reports, which the Project Steering Committee (SC) and the respective STCs will use to closely monitor the project in relation to its progress and budget execution. This management report must describe: progress made on intermediate and final outcomes as envisaged in the work program; budget execution; administrative aspects; monitoring of agreements; major goals and problems; and the measures resulting from the above, for the period under review. The specific format of this report will have to be agreed by the PCU and the SC. Every effort should be made to provide the SC with such reports prior to the meetings. The Management Report provides for follow-up and the inputs to be reported to the COF/CME.
- 6.3 **Evaluation.** The evaluation will be based on the standard methodology developed by the MIF for this cluster (Annex VIII), and the baseline designed in Component 1. Taking the instructions from said methodology, the logical framework (contained in Annex I and IB of the Summary of Indicators) provides the indicators described for program execution, monitoring and evaluation. It should be noted that, for the manufacturing sector, only the Component 1 outcomes will be evaluated.
- 6.4 The program calls for two evaluations to be conducted by a consultant with expertise in production integration, selected and hired directly by the Bank (the Country Office will coordinate with the official in charge of the MIF cluster). The first evaluation will be undertaken once the integration plans to be developed in Component 1 are ready and more than 50% of the funds have been disbursed, or 18 months after the first disbursement. This evaluation will consider, at least, the following factors: (i) evolution of the logical framework indicators (see Annex I); (ii) rate of advance of each cluster supported by the program; (iii) institutional capacity of the executing agency and other institutions involved in the program; (iv) the extent to which the counterpart has fulfilled its obligations in accordance with the Operating Regulations; and (v) the extent to which the enterprises have complied with environmental and occupational safety standards. This report must specify the corrective measures necessary to ensure that the program is properly executed.
- 6.5 The second evaluation will be conducted three months prior to the last disbursement, and will analyze: (i) the degree to which the specific project goals and objectives have been attained, basically, the degree of improvement in local competitiveness, taking into account the baseline indicators; (ii) user satisfaction, through a survey of participating enterprises; and (iii) degree of sustainability of the program-driven measures once the MIF contribution has been fully disbursed. This second evaluation will include a comparative analysis of results attained by beneficiary enterprises vis-à-vis a sample of enterprises not supported by the project.

VII. RATIONALE AND RISKS

A. Rationale

- 7.1 The following are the main reasons in justification of this initiative: (i) the importance of the leather making and footwear and garment making businesses, together with the decorative ceramics sector, in creating jobs and revenue for the State; (ii) loss of competitiveness facing the MSMEs in world markets; (iii) opportunities that such a program represents for increasing competitiveness, using effectively recognized production integration strategies to address that issue.
- 7.2 The universe of enterprises in the selected sectors consists mostly of MSMEs. Experience in other countries has shown that the best way for these enterprises to function as viable exporters, is through production integration in horizontal or vertical networks. In turn, if such initiatives are based on identifying problems and seeking common solutions, an effective instrument will be developed to improve competitiveness and promote business development.

B. Program beneficiaries

- 7.3 The direct beneficiaries of the project are approximately 200 MSMEs that are potential or current direct or indirect exporters of goods and services in the selected sectors of leather-footwear, garment making and decorative ceramics. The potential indirect beneficiaries of the project are about 2,000 enterprises and their employees in those sectors, including suppliers. Local public and private technological centers and universities, including COFOCE, also stand to benefit, bolstering their capacity to promote business coordination and integrate the enterprises into export processes.
- 7.4 The minimum criteria for selecting the beneficiary enterprises will be as follows: (i) they must be MSMEs (according to the classification used in Mexico); (ii) they must be willing to participate in the formation of clusters and the services they receive; (iii) they must be oriented to direct or indirect exporting; (iv) they must comply with Mexican environmental and occupational safety laws, and if not, compliance with such laws is provided for in the specific integration plans; and (v) they must not discriminate with respect to gender or ethnic group. In cases of supplier development or vertical chains, the large enterprises are expected to participate with contributions to the integration plan. For horizontal chains, support will be ranked on the basis of enterprises that have experience working in groups and enterprises that commit themselves to working in this format (the Operating Regulations set forth the ranking criteria).

C. Risks

- 7.5 The risks have to do with entrepreneurial behavior typical of MSMEs, including: that the change in MSME entrepreneurial culture in terms of using non-financial services, obtaining information to establish the baselines and make possible the monitoring and measuring of the success of the intervention, development of a payment for services culture, and a positive attitude among entrepreneurs to partner with other enterprises in the selected sectors does not occur. These risks are mitigated through the activities contemplated in Component I.
- 7.6 COFOCE-related risks include the potential non-availability of counterpart contributions and continuity in project development teams. A mitigating factor is the commitment of government agencies, as well as the private sector, to carry on the project and COFOCE's structure and private sector involvement on the Steering Committee.
- 7.7 Lastly, there are project-related factors, including the possibility that the exchange rate may enable Mexican exports from the selected sectors to be competitive, and that the problems of access to financing by the MSMEs in the project may be satisfactorily resolved and make possible the required changes. For all these issues, COFOCE's current structure demonstrates the capacity for negotiation and issue calls for proposals to ensure the execution of the sector coordination plans.

VIII. SOCIAL AND ENVIRONMENTAL ASPECTS

- 8.1 This operation will contribute to the mitigation of potential environmental risks directly with training and advisory services to be provided to the enterprises through Components 1 and 2, and by collaborative efforts with current state and federal programs and the MIF project mentioned in paragraph 2.9. Specifically included in Components 1, 2 and 3 are training activities and coordination with local organizations currently working on improving the environmental and occupational health practices of the enterprises. The sector coordinators will be trained in supplying existing instruments and programs for this purpose.⁷
- 8.2 Given the fact that clean production and environmental management are tools that enterprises can use to reduce their production costs and increase revenue, the linking of other MIF initiatives with public and private programs is key to the project's success. Environmental improvements will be evaluated in the quarterly project management report (further details on the inclusion of these activities into the project are set forth in Annexes I, II and III).

⁷ Specific instruments available in the NAFIN, SEMARNAT and other government units.

IX. SPECIAL CONTRACTUAL CONDITIONS

- 9.1 Conditions precedent to the first disbursement will be the submission, to the Bank's satisfaction, of the following: (i) the work plan for the first project year; (ii) evidence that the Program Coordination Unit has been formed with the hiring of the Project Executive Director and assistant; and (iii) evidence that the Steering Committee has been formed.
- 9.2 For purposes of Component 2, each sector will have the flexibility of executing disbursements separately, once it has its own integration plan under Component 1. For disbursement under Subcomponents 2.1 and 2.2, COFOCE must submit, to the Bank's satisfaction: (i) integration plans for the leather-footwear and decorative ceramics sectors; and (ii) the Sector Technical Committees operating in each sector, with their respective sector coordinators.

**PROGRAM FOR DEVELOPMENT OF PRODUCTION CHAINS TO PROMOTE EXPORT-ORIENTED MICROENTERPRISES
AND SMALL AND MEDIUM-SIZED BUSINESSES IN GUANAJUATO**

LOGICAL FRAMEWORK MATRIX

Summary of goals	Indicators	Means of verification	Assumptions
Goal			
Increase the competitiveness of the micro, small and medium-sized enterprises (MSME) of Guanajuato in the leather-footwear, ceramics and manufacturing sectors.	<p>Five years into the program, the MSMEs in the areas of influence:</p> <ol style="list-style-type: none"> 1. Increase sales by more than 10% in real value. 2. Increase productivity in terms of Added-Value/jobs by more than 5% 3. Change the average sales price ratio by \$ unit/unit by more than 5%. 4. Obtain better results, measured on the basis of the above-mentioned indicators, than a control group of enterprises not participating in the project. 	<ol style="list-style-type: none"> 1. Semiannual, midterm and final program reports 2. Program information system. 3. Annual report prepared by the sector coordinators, with baselines of enterprises participating in the project and a control group of non-participants. 	<ol style="list-style-type: none"> 1. Dollar exchange rate: peso is not overvalued, making export competitiveness possible 2. Enterprises are willing to submit information to help establish baselines for the year 2003 and a control group can be set up with enterprises having features similar to the project participants 3. COFOCE has its own resources and in conjunction with other sources to continue large-scale implementation of this kind of strategy.
Purpose			
Contribute to the integration of micro, small, and medium-sized enterprises (MSME) in the leather-footwear, ceramics and manufacturing sectors of Guanajuato into the export process directly or indirectly by strengthening productive integration in those sectors.	<p>Thirty-six months into the project, the MSMEs report the following outcomes relative to their 2003 baselines:</p> <ol style="list-style-type: none"> 1. Of the enterprises that were exporting directly, their total export volume has increased by 5% 2. Of the enterprises exporting indirectly through brokers and consortiums or as export suppliers, their total sales are increased by 10% 	<ol style="list-style-type: none"> 1. Foreign trade registries 2. Annual survey from 2003 on by COFOCE on Guanajuato enterprises exporting directly or indirectly 3. Six-month, mid-term and final program reports 4. Program information system 	<ol style="list-style-type: none"> 1. COFOCE sets up an annual survey for export enterprises with the pertinent questions 2. Change in the payment for services culture of the entrepreneurial sector 3. Program and strategy designed by COFOCE to support the MSMEs is effective. 4. External markets remain stable.

Summary of goals	Indicators	Means of verification	Assumptions
	3. 30 of the enterprises that were not exporting directly before are now doing so 4. Of the non-exporting enterprises, at least 200 are exporting indirectly, through brokers, consortiums, as export suppliers, etc. 5. COFOCE establishes a monitoring system that allows it to obtain updated information on each sector		
Components			
1. Coordination between enterprises and formation of the production chain.	Six months into the project, the following has been carried out: 1.1 Coordination plan for each of the three sectors, identifying specific actions and at least 20 enterprises in each sector prepared to be involved in the plan. 1.2 Two to three prospective entrepreneurial clusters identified by sector. 1.3 For the manufacturing sector: at least one production chain project prepared for presentation to the FIDECAP	1. Semiannual, mid-term and final program reports 2. Steering Committee minutes 3. Letter of commitment signed by the enterprises interested in participating 4. Coordination plan for each sector	1. Interest and involvement of the enterprises and other institutions 2. Availability of skilled staff for training purposes and technical assistance 3. Institutional coordination by COFOCE is effective.

Summary of goals	Indicators	Means of verification	Assumptions
2. Implementation of Sector Integration Plans	<p>36 months into the project:</p> <p>2.1 Two to three enterprise clusters have been developed for the footwear sector (export consortium) and the ceramics sector, and supplier development experience has been established</p> <p>2.2 60 enterprises in the selected sectors have received technical assistance and training on the subjects identified in the respective integration plans.</p> <p>2.3 At least five support institutions work with the enterprise clusters to improve production</p> <p>2.4 Five products have been developed for each sector with advisory assistance from outside designers aimed at meeting the demands of enterprise clusters</p> <p>2.5 Joint production marketing has been promoted through studies to seek out new export markets and training in export techniques</p> <p>2.6 Know-how and best practices of the enterprises and workers have been disseminated on issues involving the environment and working conditions, in conjunction with the MIF cleaner production programs</p>	<p>1. Individual and collective working plans</p> <p>2. Prepared list and evaluation of compatibility with needs</p> <p>3. Agreements signed</p> <p>4. Semiannual, mid-term and final reports</p> <p>5. Event records</p>	<p>1. Enterprises are prepared and have the ability to pay</p> <p>2. Minimum quality of technical assistance services</p> <p>3. The enterprises are prepared to participate in the events</p> <p>4. Possible coordination with the MIF cleaner production project in the Bajío region.</p>

Summary of goals	Indicators	Means of verification	Assumptions
3. Modernization of COFOCE enterprise services	<p>3.1 12 months into the project, the Project Coordination Unit will have submitted to the COFOCE Steering Committee for its approval a program for integrating the MSMEs into export processes, taking into consideration strategic factors, support instruments, services, forms of operation, resources, policies on partnerships, and training elements, among other things</p> <p>3.2 36 months into the project, COFOCE will have developed with a potential exporter an MSME integration program model that can be replicated in other sectors</p> <p>3.3 Four months into the project, the PCU will have developed an annual survey and methodology for follow-up indicators</p>	<p>1. Minutes of the COFOCE Board of Directors on the appropriate dates</p> <p>2. Survey and methodology document attached to the Board minutes</p> <p>3. Results of the annual survey and project management report on the appropriate dates</p>	<p>Support institutions are interested in working with COFOCE to promote the enterprises</p> <p>Enterprises are interested in participating in the project, supplying relevant information to establish a production integration model.</p> <p>COFOCE and Bank monitoring systems are compatible</p>
4. Evaluation and dissemination of the model and outcomes	<p>4.1 In July 2004 and 2005, COFOCE prepares an analysis and documented opinion on best practices in competitiveness programs, establishing dissemination methods</p> <p>4.2 In July 2006, COFOCE has “packaged” at least four best practices cases in audiovisual or written media and has a program to disseminate them.</p>	<p>1. Project documents attached to minutes of the Board of Directors for the applicable years</p> <p>2. The documents or cases in multimedia, in the hands of the EU of COFOCE.</p>	<p>Availability of project evaluations and information</p> <p>The enterprises and institutions are prepared to create networks</p> <p>Local capacity for developing successful initiatives</p>